



Heritage Alternative Investments

Monthly Review & Outlook

61 Route de Chêne
PO Box 6600
1211 Geneva 6
Switzerland

March 2012

Tel +41 58 220 0774
advisory@heritage.ch

Disclaimer

This document is intended for informational purposes only and should not be construed as an offer or solicitation for the purchase or sale of any financial instrument mentioned herein or as contractual document. This document is not intended for distribution, publication or use in any jurisdiction where such distribution, publication or use would be unlawful nor it is directed to any person or entity to which it would be unlawful to direct such a document. The opinions herein do not take into consideration specific investment objectives, financial situation or particular needs of any person who may receive this document. Each person must make his own independent analysis, with professional advisors if necessary, before investing in any security, financial instrument or financial market mentioned herein. The information provided is based on sources believed to be reliable. However, Heritage Bank does not guarantee its completeness or accuracy nor does it accept any liability for any loss or damage resulting from its use. All information and opinions as well as prices, market valuations and calculations contained herein are subject to change without notice. Past performance is no guarantee of current or future returns.



Performance Review

Our main fund \$ class finished March down -0.50% net and is +0.57% YTD. Below is the breakdown of gross contributions by styles and strategies:

- **Directional styles (-26bps):** Global Macro -10bps, Equity Long/Short -16bps.
- **Less-Directional styles (-9bps):** Credit/Distressed/Event-driven +4bps and Relative Value -13bps.
- **Hedges: -11bps YTD.**

Global Macro strategies (28% allocation) generated a performance of -0.35% vs. -0.79% for the Macro indices' average (HFRI, HFRX, Tremont, Barclays and UCITS).

Our global macro managers posted performance ranging from -2.65% to +1.58%. Money was lost in FX and the sharp reversal in gold while returns were generated by long positions in fixed income.

Equity Long/Short strategies (26% allocation) posted a performance of +0.63% vs. -0.25% for the main ELS indices' average (HFRI, HFRX, Tremont, Barclays and UCITS). Performances ranged from -3.04% (Energy and shipping specialist) to +0.89% for one of our US manager. The market environment was challenging for Europe and Asia while still constructive for the US. As expected, markets took a breather and are now consolidating.

Credit/Distressed/Event-driven strategies (18% allocation) returned +0.24% vs. +0.40% for the main CDE indices' average. The style total contribution reached +4bps for the month. Gains were generated by our global EM and Asia credit Long/Short managers (combined +9bps contribution) while our developed credit exposure did generate -1bps of contribution.

Relative Value strategies with an allocation of 25% returned -0.53% vs. +0.22% for the main Relative Value indices' average. Total contribution for the month reached -13bps. Most of our

exposure in RV is focused on equity market neutral: developing markets specialists had a +11bps contribution while developed markets dedicated managers suffered and detracted -24bps to the fund's performance. Sharp reversal in fixed income prices were the main culprit behind the

Top 5 contributors in March:

1.	GM/Commodities	=> + 9bps
2.	RV EM Neutral	=> + 8bps
3.	CDE/EM Credit L/S	=> + 7bps
4.	GM/Commodities	=> + 6bps
5.	ELS/US LS	=> + 4bps
	Total	= +34bps

Top 5 detractors in March:

1.	RV/Multi-Strategy	=> -19bps
2.	ELS Sector	=> -13bps
3.	GM/Asia	=> -12bps
4.	GM/Commodities	=> -12bps
5.	RV/EM	=> - 4bps
	Total	= -60bps

Heritage Alternative Funds (Net of fees)

Fund of Hedge Funds Results	MARCH	YTD
Heritage Total Return USD	-0.50%	0.57%
Heritage Long / Short Equity USD	-0.07%	2.23%

HFRX Indices

2012 - ROR (Gross of fees)	MARCH	YTD
Global Hedge Fund Index	-0.02%	3.14%
HFRX Macro Index	-1.60%	-1.29%
HFRX Equity Hedge Index	0.40%	3.94%
HFRX Event-Driven Index	0.56%	5.81%
HFRX Relative Value Arbitrage Index	0.27%	3.56%

UCITS Alternative Index

2012 - ROR (Gross of fees)	MARCH	YTD
Fund of Funds (Net of fees)	-0.80%	0.36%
Macro	-0.64%	1.92%
Long/Short Equity	-0.25%	2.49%
Event-Driven	-0.08%	2.17%
Equity Market Neutral	-0.24%	0.49%



Outlook

The next chapter of the Euro crisis has shifted back to Spain again. While the LTRO have boosted liquidity in the European banking system, they may have worsened bank solvency problems by encouraging peripheral banks to buy government securities whose prices have subsequently declined! As a result, the country may need to tap the funds in the EFSF to recapitalise its banks. A more dramatic solution would be to follow Greece, Ireland and Portugal in securing a full-fledged bailout programme with the IMF, ECB and EU.

This is happening in a context of growth deceleration in the US expected in Q2. The tailwinds provided by inventory restocking, the warm winter and strong auto sales are currently diminishing. Furthermore, uncertainties over fiscal policy in the second half of the year may undermine confidence. The recent disappointing employment figures are just adding fuel to the fire. Yet we should keep things in perspective. Payroll growth tends to be fairly volatile on a month-to-month basis.

However, the most likely scenario is that GDP growth in Q2 will fall back to around 2%. A number of leading indicators such as the drop in the new orders component in the ISM and various regional Fed surveys and weekly jobless claims are already foreshadowing the deceleration.

As we look into the second half of the year and 2013, the key questions will revolve around what happens to gasoline prices, the US housing market and fiscal policy, China hard/soft landing, and the degree to which the turmoil in Europe spills over to the US.

The current economic environment poses a serious dilemma for investors. On the one hand, the euro crisis is unlikely to be resolved any time soon, which leaves the market vulnerable to another correction. On the other hand, even if global growth is losing momentum, growth in the US and

in the developing world is decent. As a result holding cash is not appealing considering that short-term rates are near zero and inflation is running at around 2%. So the best strategy for investors (not too fussy about short term volatility) is to remain cautiously overweight risk assets and use liquid strategies to protect the portfolio from sudden corrections.

Within this context, our sense is that the most probable scenario is the consensus and as a result **we recommend a Neutral weight towards global macro strategies while maintaining our neutral allocation to ELS, CDE & increase our weighting to the RV space from Neutral to overweight.**

Macro Scenario Probabilities

Consensus	30%
Stagflation	30%
Double Dip	20%
"Goldilocks" (Low Inflation / Strong GDP)	10%
Depression	10%

2012 Consensus

US GDP	2.5%
Inflation Environment	2.4%
Unemployment	7.9%
Federal Rate Hike	0.15%

Portfolio Analysis

Our main fund entered March with a 54% allocation to directional strategies, broken down as follows: 28% to GM and 26% to ELS. On the other hand, 43% is allocation to less directional strategies, split as follows: 19% to Credit/Distressed/Event and 24% to RV.

Our main fund still has 19 investments: 5 GM, 6 ELS, 3 CDE, 5 RV and no hedge. Top 5 allocations account for 30% while the top 10 investments reach 55%.

Allocation Summary

OVERWEIGHT



UNDERWEIGHT

